



## FULL ANALYSIS

### I. SUBSTANTIVE ANALYSIS

#### A. HOUSE PRINCIPLES ANALYSIS:

Provide limited government – This bill will provide a trustee additional options for establishing a trust or when administering the expenses of a trust.

#### B. EFFECT OF PROPOSED CHANGES:

The bill addresses three separate areas related to the administration of trusts: expansion of the Uniform Transfer-on-Death Security Registration Act to bank and trust company investments; clarification to the payment of trustee's costs and attorney's fees; and changes to the Uniform Principal and Income Act (UPIA).

#### Trusts

There are several different forms of trusts, and numerous types of property held by trusts. The trustee of a trust and the personal representative of a decedent's estate are considered fiduciaries.<sup>1</sup> The trustee has a fiduciary duty toward the beneficiaries of the trust to manage the trust properly to satisfy both the interests of the trust's income beneficiaries during the life of the trust and the interests of the remainder beneficiaries at the trust's termination, except to the extent that the terms of the instrument clearly indicate that the fiduciary shall or may favor one or more beneficiaries.<sup>2</sup>

A trustee's management of any trust involves an inherent conflict between the interests of current beneficiaries and future beneficiaries. The current beneficiaries seek the largest possible payout given to them from the trust, while the future beneficiaries seek the minimum possible payout to present beneficiaries in order to maximize the amount that the future beneficiary will receive. Determining the proper balance between current beneficiaries and future beneficiaries necessarily entails difficult policy considerations. The grantor of a trust generally provides a distribution plan within the trust document that the grantor deems appropriate. There are many situations, however, where the terms of a trust do not clearly specify how the distribution of the trust assets is to be made.

Chapter 711, F.S., regulates the registration of securities in beneficiary form.<sup>3</sup> The provisions of this chapter provide for the ability to register securities in joint security accounts and other types of security accounts with a survivorship feature.<sup>4</sup> A security account is defined as either:

- (a) A reinvestment account associated with a security, a securities account with a broker, a cash balance in a brokerage account, cash, interest, earnings, or dividends earned or declared on a security in an account, a reinvestment account, or a brokerage account, whether or not credited to the account before the owner's death; or
- (b) A cash balance or other property held for or due to the owner of a security as a replacement for or product of an account security, whether or not credited to the account before the owner's death.<sup>5</sup>

The provisions of ch. 711, F.S., do not apply to accounts within investment agencies, banks, or trust companies.

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<sup>1</sup> Section 738.102(3), F.S.

<sup>2</sup> Section 738.103 (2), F.S.

<sup>3</sup> Chapter 711, F.S., is known as the "Uniform Transfer-on-Death Security Registration Act" pursuant to s. 711.50,F.S.

<sup>4</sup> A "security" is defined as "a share, participation, or other interest in property, in a business, or in an obligation of an enterprise or other issuer, and includes a certificated security, an uncertificated security, and a security account." See section 711.501(9), F.S.

<sup>5</sup> Section 711.501(10), F.S.

## Legal Proceedings

Trustees, at times, may be involved in legal proceedings relating to the trusts which they administer. When legal proceedings are instituted, trustees are required to retain and pay legal counsel. Florida courts have broad supervisory authority over the payment of costs and attorney fees in connection with these trust proceedings.<sup>6</sup> Courts may order a party to pay another party's costs and attorney's fees.<sup>7</sup> Courts may also order the reimbursement of excessive fees paid to attorneys by a trust.<sup>8</sup>

Based on its interpretation of s. 737.403(2), F.S.,<sup>9</sup> the Fourth District Court of Appeal has ruled that, in a case involving a breach of trust allegation against the trustee, a conflict of interest is present and a trustee cannot pay its costs and attorney's fees from trust assets without prior court approval.<sup>10</sup> The Court indicated that the trustee in this case should have obtained court approval prior to paying attorney fees from the assets of the trust even though payment from trust assets came after the breach of trust allegation was resolved by the court in favor of the trustee.<sup>11</sup><sup>12</sup> Based on this ruling, advance court approval is now required for payment of a trustee's costs and attorney's fees from trust assets when the proceeding involves an allegation of breach of trust by the trustee. In situations where advance approval is not required, the customary practice of a trustee is to pay his or her costs and attorney's fees from assets of the trust unless a contrary order is imposed by the court.

It has been reported that “[m]ost trust proceedings are resolved through settlement or other means that do not involve a contested hearing or trial. It is unreasonable to require trustees to seek prior court approval to pay costs and attorney's fees from trust assets in all cases merely because there has been a breach of trust allegation at some point in the proceeding. The better approach is to require a trustee to seek prior court approval only when the breach of trust allegation is pending. Once resolved, the trustee can pay fees from trust assets unless the court has ordered the trustee to bear its own costs and attorney's fees, or unless the breach of trust has been established.”<sup>12</sup>

## Florida Uniform Principal and Income Act

Chapter 738, F.S., governs the identification of principal and income in or from a trust property through a trust instrument, will, or other governing instrument, the allocation of principal and income, and the apportionment of assets between income and principal. In 2002, the Legislature substantially revised ch. 738, F.S., by enacting Florida's Uniform Principal and Income Act (UPIA).<sup>13</sup> The UPIA made sweeping changes to Florida's principal and income laws. In 2003, the Legislature adopted further revisions to ch. 738, F.S., making technical and clarifying changes to the UPIA.<sup>14</sup>

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<sup>6</sup> Section 737.2035, F.S.

<sup>7</sup> Section 737.4033, F.S.

<sup>8</sup> Section 737.204(3), F.S.

<sup>9</sup> Section 737.403(2), F.S., reads: “(2) If the duty of the trustee and the trustee's individual interest or his or her interest as trustee of another trust conflict in the exercise of a trust power, the power may be exercised only by court authorization, except as provided in s. 737.402(2)(a), (e), (g), (s) and (y). Under this section, personal profit or advantage to an affiliated or subsidiary company or association is personal profit to any corporate trustee.”

<sup>10</sup> *Shriner v. Dyer*, 462 So.2d 1122 (Fla. 4th DCA 1984).

<sup>11</sup> *Id.* at 1124.

<sup>12</sup> Florida Bankers Association, the Real Property, Probate and Trust Law Section of the Florida Bar Florida, and the Florida Institute of Certified Public Accountants, White Paper: *SB 1688/HB 897 Trusts & Other Agency Relationships*, on file with the House Civil Justice Committee.

<sup>13</sup> Chapter 2002-42, L.O.F. This Act is based upon the Uniform Principal and Income Act (1997) promulgated by the National Conference of Commissioners on Uniform State Laws (NCCUSL). Florida's Act also includes a number of provisions not found in the NCCUSL version of the uniform act.

<sup>14</sup> Chapter 2003-43, L.O.F.

The intent of the Act is to:

- Provide procedures for trustees and personal representatives in the administration of a trust or an estate;
- Provide greater specificity for allocation of assets to principal and income;
- Ensure proper distribution to beneficiaries, heirs, and devisees; and
- Reflect changes in principal and allocation rules consistent with modern trust investment principles and practices.<sup>15</sup>

The guiding principle under chapter 738, F.S., is to ensure that the intent of the creator of the trust governs the interpretation and construction of the trust. Therefore, the default rules of chapter 738, F.S., are only operative in the event a trust document, will, or other governing instrument is silent. Additional changes have been identified by interested industry groups that were proponents of the UPIA.<sup>16</sup> These technical and clarifying issues are as follows:

Issue 1. Section 738.104(3)(h), F.S., prohibits a trustee from making an adjustment to a trust if the adjustment would benefit the trustee directly or indirectly. Trustees who are paid an annual fee based upon the value of trust assets arguably benefit indirectly by adjustments to assets from income to principle. Proponents of the bill have suggested clarifying that the trustee's fee arrangement does not violate this standard.

Issue 2. Section 738.1041(12), F.S., states that the section "shall be construed as pertaining to the administration of a trust." Proponents have suggested that similar language should be included in s. 738.104, F.S., to make it clear that if administration of a trust is governed by Florida law, but the substantive provisions are governed by the laws of another state, then adjustments under s. 738.104, F.S., are to be considered administrative and are applicable to trusts administered in Florida, or administered under Florida law.

Issue 3. Section 738.1041, F.S., provides for the regulation of total return unitrusts.<sup>17</sup> This section uses the term "fair market value" throughout; however, the term is not defined. This section also uses the term "unitrust amount;" however, this term is also not defined. Other terms are defined in subsection (1).

Issue 4. Additionally, it has been reported that current s. 738.1041(1)(b), F.S., may be read to prohibit unitrust treatment to trusts which are subject to estate or gift tax long after the creation of the income and remainder interests. For example, a qualified domestic trust is not subject to tax until distribution to, or death of the surviving spouse. Proponents of the bill have suggested clarifying that unitrust treatment may apply to all trusts that contain both a principal and income interest.

Issue 5. It has been reported that practitioners find the provisions of s. 738.1041(2)(b), F.S., to be confusing. The statute sets forth two different sets of rules that must be followed by a trustee developing a unitrust plan, one which is only available to a disinterested trustee, or disinterested person appointed by a disinterested trustee, and the other set is designed for an interested trustee, but may be used by a disinterested trustee. Proponents of the bill have suggested allowing a disinterested trustee to use either option.

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<sup>15</sup> The National Conference of Commissioners on Uniform State Laws, *Uniform Principal and Income Act (1997)*, available at [http://www.nccusl.org/Update/uniformact\\_summaries/uniformacts-s-upaia1997.asp](http://www.nccusl.org/Update/uniformact_summaries/uniformacts-s-upaia1997.asp) (last visited March 9, 2005).

<sup>16</sup> Florida Bankers Association, the Real Property, Probate and Trust Law Section of the Florida Bar Florida, and the Florida Institute of Certified Public Accountants, White Paper: *SB 1688/HB 897 Trusts & Other Agency Relationships*, on file with the House Civil Justice Committee.

<sup>17</sup> While the provisions of s. 738.1041, F.S., address the regulation of total return unitrusts (TRU) in Florida, the term "total return unitrust" is not defined in statute. A TRU is a financial and estate planning tool which pays the current income beneficiary a fixed percentage based on the value of the trust. This frees the trustee to manage the trust based on total return on the investments, whether it benefits income or principle.

Issue 6. Section 738.1041(2)(e), F.S., provides that a unitrust plan will go into effect unless an interested person objects. The objection period is 60 days from receipt of the plan. It has been reported that, in practice, this requirement forces a trustee to verify that a plan, which was properly served on a beneficiary, is actually received by the beneficiary before the unitrust plan may be implemented. Proponents of the bill suggest that the 60 day period should begin from the proper service of the plan, without regard to proof of receipt.

Issue 7. Section 738.105(3), F.S., provides trustees with protection from liability under certain circumstances and provides a remedy when a trustee is found to have abused its discretion. The remedy is to restore the income and remainder beneficiaries to the positions they would have occupied had the trustee not abused its discretion.<sup>18</sup> It is unclear whether these provisions apply to a trustee who submits or fails to submit a unitrust plan or modification to a unitrust plan. Proponents of the bill have suggested modifying s. 738.1041(10), F.S., to address this point.

Issue 8. Often the "administration" of a trust is governed by the law of one state and the "rights of beneficiaries, construction and validity" are governed by the law of a different state.<sup>19</sup> Section 738.1041(12), F.S., states that the section "shall be construed as pertaining to the administration of a trust and shall be available to any trust that is administered in this state under Florida law." Proponents of this bill have suggested that the option should not be limited to trusts administered in Florida, but should be available to all trusts, the administration of which is governed by Florida law.

Issue 9. Section 738.1041, F.S., allows an income trust to be converted into a unitrust, but no statutory provision exists which would allow a settler of a trust to create a unitrust from the inception of the trust.

Issue 10. Section 738.301(4), F.S., states "an income interest ends on the day before an income beneficiary dies." Section 738.303(1), F.S., states that undistributed income is net income received "before the date on which an income interest ends." Since an income interest ends the day before the income beneficiary dies, and undistributed income is income received before the date the income interest ends (e.g. before the day before the death of the beneficiary), then technically undistributed income is only that income received 2 days before the income beneficiary dies. As presently written, there is confusion over income received the day before the beneficiary's death.

Issue 11. Section 738.401, F.S., provides that money (such as a dividend) received from an entity is ordinarily treated as income. When a trust is invested in an entity, a problem may arise, particularly with tiered entities, when the entity distributes cash representing proceeds from refinancing or a downstream divestiture of assets when the distribution does not exceed the 20% threshold outlined in s. 738.401(5), yet still represents a return of capital. In the case of a C corporation, the determination of what amount of a distribution is a tax free return of capital may be determined by the tax status of the distribution. The same guidance is not available in the case of a partnership, subchapter S corp., LLP, or LLC. Additionally, a further problem is presented when a trustee uses an entity for the purpose of pooling monies with other entities to purchase marketable securities. While the entity may be generating capital gains and losses, s. 738.401, F.S., does not allow the trustee to "look through" the entity to determine the true nature of the source of the distribution. This would, in effect, allow the trustee to convert what would have otherwise been principal into income by simply choosing to invest in marketable securities through an entity instead of making a direct investment. The pooling of monies may be logical choice when it is done to obtain professional management at a discounted rate and could benefit the trust. However, proponents of the bill suggest that making such a choice should not change the basic nature of the underlying income.

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<sup>18</sup> Section 738.105(3), F.S.

<sup>19</sup> See George Gleason Bogert, *The Law of Trusts and Trustees* §§ 293, 297, and 861 [2d ed. (rev.) 1992].

Issue 12. It has been reported that new regulations adopted by the Internal Revenue Service have rendered obsolete certain provisions of the UPIA which were intended to protect trusts from adverse tax consequences because of the trustee's power to adjust or make a unitrust conversion. The need for s. 738.104(3)(a), F.S., a portion of s. 738.1041(1)(b), F.S., s. 738.1041(5) and (9), F.S., and a portion of s. 738.1041(12)(b), F.S., has been eliminated.

## HB 897

The bill addresses the following three areas of trust law:

- Amends the Uniform Transfer on Death Security Registration Act to allow investment accounts at banks and trust companies to be held in joint accounts and other types of accounts with a survivorship feature.
- Provides that trustees who are involved in court proceedings may pay their attorney fees from assets of the trust account without prior court approval, except when the litigation includes a claim or defense based upon a breach of trust by the trustee.
- Provides several changes to the Florida Uniform Principal and Income Act, including:
  - That it is not a conflict of interest for a trustee whose compensation is based on the value of the trust to make adjustments which affect the value of the trust;
  - Creating a new subsection (11) to s. 738.104, F.S., to provide that the section pertains to the administration of trusts and is available for any trust administered under the laws of Florida;
  - Providing a definition of "fair market value" and a definition of "unitrust amount";
  - Allowing a disinterested trustee a choice between two sets of rules when developing a unitrust plan;
  - Providing that a unitrust plan may go into effect 60 days after service of the plan to the beneficiaries, without regard to proof of receipt of the plan;
  - Amending s. 738.1041(10), F.S., to specifically make applicable the provisions of s. 738.105(3), F.S., to trustees over unitrusts;
  - Amending s. 738.1041(12), F.S., to provide that the unitrust election is available for any trust administered under the laws of Florida;
  - Allowing a settler of a trust to create a unitrust from the inception of the trust;
  - Defining "undistributed income" as income earned on or before the day that the income interest ends. In the case of a unitrust, the term will mean the daily pro-rated unitrust amount ending on the day the income interest ends;
  - Providing special rules for money or property received by a private trustee from entities for determining whether the money or property is income or principal; and
  - Repealing several sections of law rendered unnecessary following the adoption of new regulations by the Internal Revenue Service.

### C. SECTION DIRECTORY:

**Section 1.** Amends s. 711.501, F.S., relating to the definition of "security account" to allow investment accounts at banks and trust companies to be held in joint accounts and other types of accounts with a survivorship feature.

**Section 2.** Amends s. 737.402, F.S., relating to the powers of trustees, to provide that trustees who are involved in court proceedings may pay their attorney fees from assets of the trust account without prior court approval.

**Section 3.** Amends s. 737.403, F.S., relating to transactions involving a conflict of interest, by establishing a number of actions that may be taken by a trustee without court approval.

**Section 4.** Amends s. 738.104, F.S., relating to a trustee's power to make adjustments, by allowing a trustee whose compensation is based upon the value of the trust to make adjustments that may affect the value of the trust, without that adjustment being considered a benefit to the trustee.

**Section 5.** Amends s. 738.1041, F.S., relating to total return unitrusts, by, for example, providing definitions of "fair market value" and "unitrust amount."

**Section 6.** Amends s. 738.303, F.S., relating to the definition of "undistributed income" for purposes of apportionment when income ends.

**Section 7.** Amends s. 738.401, F.S., relating to money or property received by a private trustee, by providing special rules for determining principal and income for money or property received from certain entities into a trust.

**Section 8.** Provides that the bill is effective July 1, 2005.

## II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

### A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

None.

2. Expenditures:

None.

### B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

None.

2. Expenditures:

None.

### C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

Providing a trustee with the ability to take advantage of more flexible trust provisions could result in more equitable trust distributions and better tax outcomes for trust beneficiaries. Allowing banks and trust companies to administer transfer on death benefits under ch. 711, F.S., relating to uniform transfer-on-death security registration, may give consumers more choices.

### D. FISCAL COMMENTS:

None.

## III. COMMENTS

### A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

This bill does not require counties or municipalities to take an action requiring the expenditure of funds, nor does it reduce the authority that counties or municipalities have to raise revenue in the aggregate, nor does it reduce the percentage of state tax shared with counties or municipalities.

2. Other:

None.

B. RULE-MAKING AUTHORITY:

N/A.

C. DRAFTING ISSUES OR OTHER COMMENTS:

None.

#### **IV. AMENDMENTS/COMMITTEE SUBSTITUTE & COMBINED BILL CHANGES**

N/A.